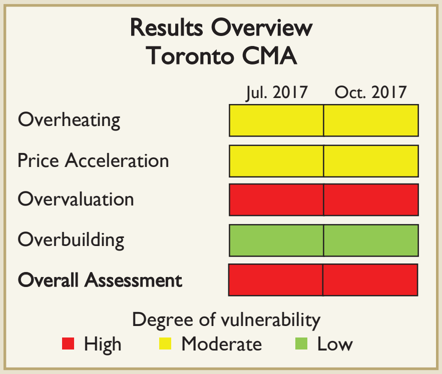
HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

Greater Toronto Area

Date Released: Fourth Quarter 2017

Highlights



- Recent results from the Housing Market Assessment indicated a high degree of market vulnerability in the Toronto CMA[1] housing market.
- We detected moderate evidence of overheating and price acceleration, and high evidence of overvaluation.
- We detected low evidence of overbuilding, as the inventory of completed and unsold units subsided further in 2017 Q2.
- The Housing Market Assessment (HMA) analytical framework considers four factors to assess the evidence of imbalanced housing market conditions: overheating; acceleration in the growth of house prices; overvaluation; and, overbuilding. A brief summary of the framework is presented on page 6 of this report.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the Housing Market Assessment (HMA), CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's Market Analysts' knowledge of local market conditions. These insights position CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects degrees of vulnerability in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates due to supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolve an excess supply imbalance by supporting stronger demand and/or reducing supply. However, other unexpected developments that do not originate from the housing market could accentuate or reduce an imbalance.

Colour codes indicate the degrees of market vulnerability. The HMA is a comprehensive framework that considers the intensity of signals of imbalances (that is, how far the indicator is from its historical average), and the persistence over time. Generally, low intensity and persistence are associated with potentially low degree of vulnerability. As the number of intense and persistent signals increases, the associated degree of vulnerability increases.

In Detail

Overheating

Following the announcement of the Fair Housing Plan by the Provincial Government of Ontario in April 2017, sales in the Greater Toronto Area (GTA) have regressed strongly from their record levels registered earlier this year while the supply of new listings reached an all-time high, bringing down the SNLR in 2017 Q2 to 0.45. There is some evidence that buyer and vendor price expectations moderated leading up to the implementation of this new plan resulting in changing behaviour after the policy came into effect. This follows six consecutive quarters of the sales-to-new listings ratio being above the threshold of 0.70. However, given that this change had only persisted for just one quarter

[1] Results are based on data as of the end of June 2017 and local market intelligence up to the end of September 2017. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

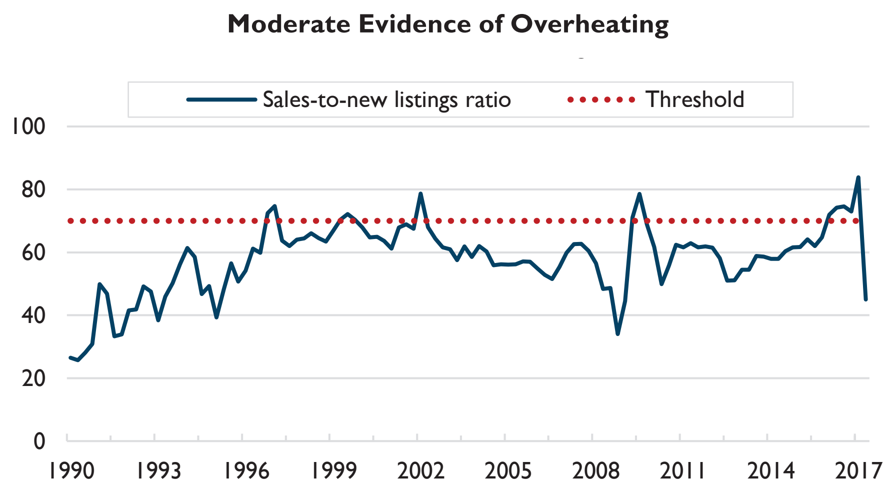
so far, we continued to detect moderate evidence of overheating. The imbalance was most evident for resale single-detached homes, which saw their sales-to new listings ratio dropping to 0.38 compared to 0.60 for condominium apartment units. Although the lower priced condominium apartment sector was not immune to the recent market cooling, their prices declined at a less pronounced pace. Condominium apartment market conditions remained tight with a seasonally adjusted SNLR of 0.61 during the same period.

Since 2017 Q2 however, supply has started to stabilize and declines in sales have eased. The supply of new listings peaked in May at a seasonally adjusted annual rate of almost 222,000 units and have since trended lower. New listings settled at a seasonally adjusted annual rate of 148,000 units in August. The number of active listings have remained high but stable (Figure 2). Thanks to an improvement in sales and a lower number of new listings, the seasonally adjusted SNLR in August 2017 recovered to 0.56. However, market conditions varied across dwelling types and regions (Table 1). Soft market conditions persisted for single-detached homes, particularly in York and Halton Regions, where

Dana Senagama, Principal, Market Analysis (GTA)

"While overall housing market conditions have started to balance in the Toronto CMA following the announcement of the Fair Housing Plan in April 2017, changes in economic fundamentals such as income and population still cannot explain high house prices."

Figure 1



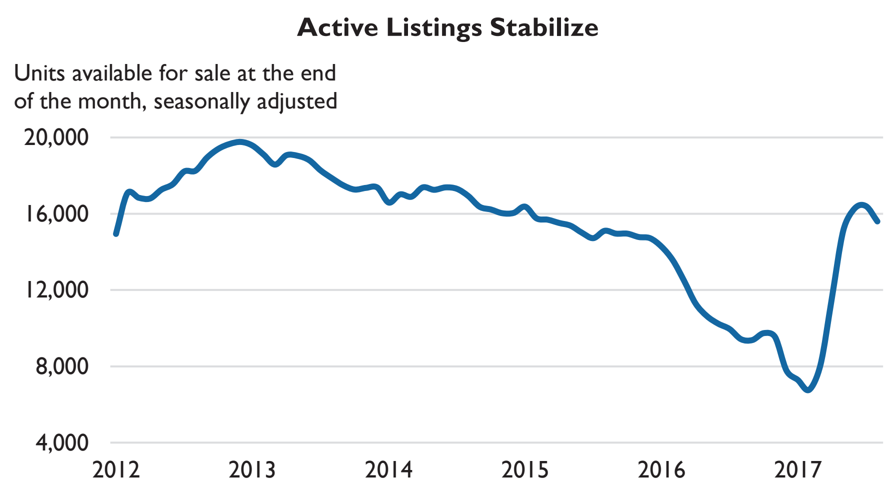
Sources: CREA and calculations (threshold) by CMHC. Last data point: 2017 Q2

Table 1: Sales-to-New Listings Ratios (August 2017)

	Single-Detached	Row*	Apartment	Total
Halton Region	55%	63%	66%	57%
Peel Region	39%	63%	59%	49%
City of Toronto	57%	62%	74%	69%
York Region	35%	62%	50%	42%
Durham Region	51%	62%	56%	55%
GTA	46%	62%	69%	56%

Source: TREB *Condominium and freehold

Figure 2



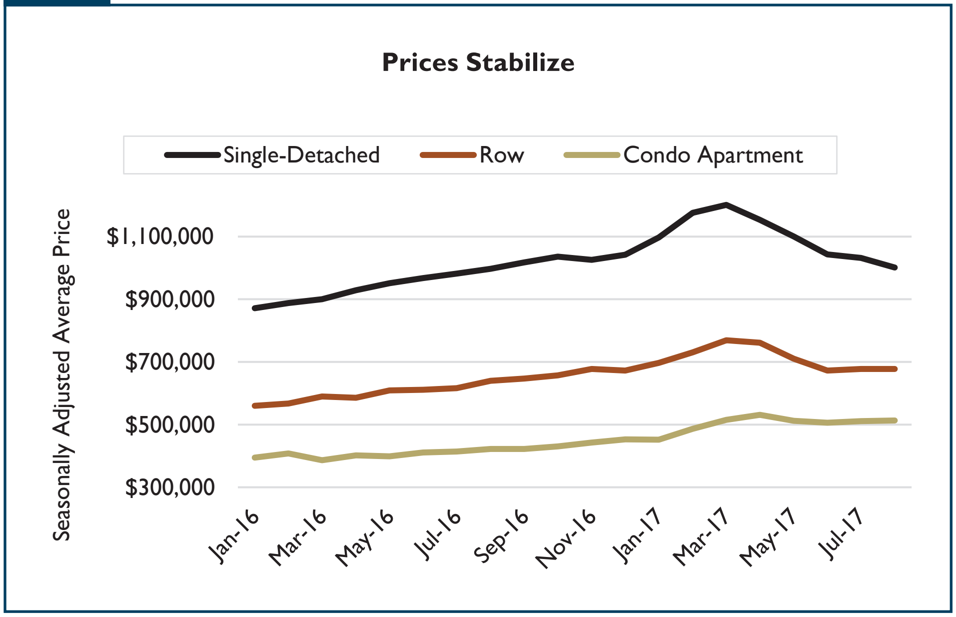
Source: TREB, CMHC seasonal adjustment. Last data point: August 2017 there was a high concentration of expensive homes. In the relatively affordable row and condominium apartment segments, tight market conditions prevailed.

Price Acceleration

Despite easing market conditions, we continued to detect moderate evidence of price acceleration in 2017 Q2. The nominal average MLS® house price increased by 16% on a year-over-year basis in 2017 Q2. Sustained evidence of price acceleration reflects higher price growth among all housing types, with the average price growth in condominium apartments outpacing that of single-detached homes in 2017 Q2.

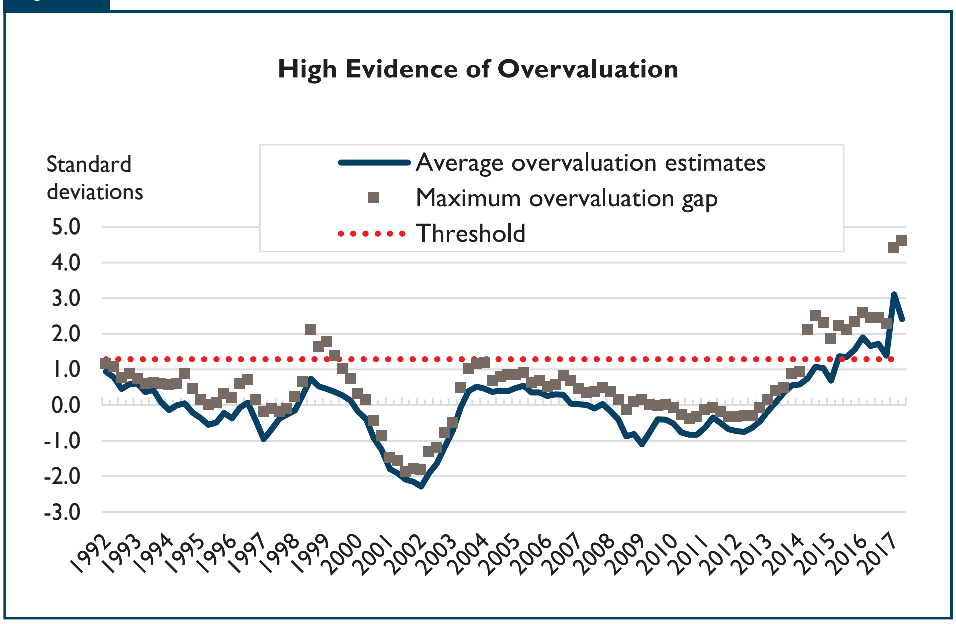
At the same time, following the announcement of the Fair Housing Plan in April 2017, the seasonally adjusted MLS® average house price declined by 2.8% from their peak level in Q1. While this trend was evident across all housing types and regions within the GTA, policy changes had a bigger impact on pricier sub-markets and expensive homes. The share of single-detached homes sold over $1 million dropped to levels seen twelve months ago. Fewer sales of higher priced homes put stronger downward pressure on the overall average price in the GTA. Relatively affordable housing types showed greater resilience. While the average price of a single-detached home have been trending lower since April, the average prices of condominium apartments and row homes showed a mild rebound in July and August.

Figure 3



Source: TREB, CMHC seasonal adjustment

Figure 4



Sources: CREA, Statistics Canada and calculations by CMHC
Note: A standard deviation larger than 1.29 is considered significant. 10% of observations are above the threshold.
Last data point: 2017 Q2

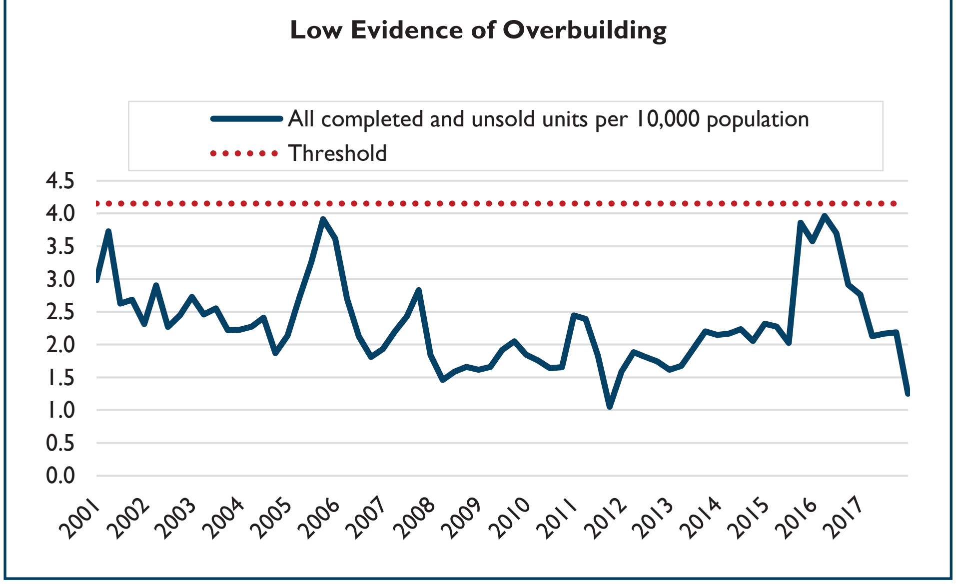
Overvaluation

While the rate of house price growth has slowed following the announcement of the Fair Housing Plan, fundamental economic drivers such as income and population growth could not explain prevailing high house prices. We continue to detect high evidence of overvaluation. All five overvaluation models used in the HMA framework were above the threshold (see Figure 4). The model that showed the highest increase in overvaluation was the Teranet supply model. Teranet HPI registered the highest ever-recorded quarter-over-quarter change of 8.1%.

Overbuilding

Low evidence of overbuilding was detected in 2017 Q2, as the number of completed and unsold units remained stable and well below the threshold (see Figure 5). Strong condominium and rental demand continued to help absorb excess supply.

Figure 5



Sources: CMHC. Statistics Canada and calculations (threshold) by CMHC
Last data point: 2017 Q2

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (1) overheating (when demand outpaces supply); (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below); and, (4) overbuilding (when the inventory of available housing units is elevated).

For each factor, the framework tests for: (1) the incidence of signs of vulnerability, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect vulnerability. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect vulnerable housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect vulnerabilities relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify signs of overheating, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers. The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed. To assess signs of overbuilding in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators that can identify imbalances. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators showing vulnerability from the previous assessment.

* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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